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UNCLAS OTTAWA 003577

SIPDIS

DEPT FOR WHA/CAN (HOLST) AND INR (SALCEDO)
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SUBJECT: CANADA'S ECONOMY STRONG AS ELECTION CAMPAIGN
KICKS OFF

REF: OTTAWA 3366 (GOC'S FALL ECONOMIC STATEMENT)

1. Canada's economy continued to accelerate in the third quarter of 2005, rising 3.6% on a real annualized basis (versus 3.4% in the second quarter and 2.0% in the first). While Canada's currency and stock markets have recently appreciated in line with energy prices, media reports tended to overstate the connection of GDP growth to high oil and gas prices in the third quarter. Incentive-driven exports to the U.S. of autos and parts also played a major role.

2. Production in the mining, oil and gas extraction sector increased 3.2% in the third quarter, while production of motor vehicles was up 4.9%. The sustained boom in Canada's energy sector has lifted business investment, which rose 12.2% in the quarter. On the other hand, the housing sector weakened by 0.2% and is now down 2.7% from its peak at the end of 2004.

3. Canada's economy remains in good shape by historical standards, with low unemployment, respectable growth, moderate inflation, declining official debt, and the federal government budget in its eighth year of surplus. Prime Minister Paul Martin and Finance Minister Ralph Goodale emphasized this message in the fall economic statement delivered on November 14 (reftel), which promised personal and corporate tax cuts spread over five years. Their Liberal Party is running in part on its economic record in the general election campaign which began on November 29 and will end with a vote on January 23.

4. That being said, in recent weeks the economic horizon has been darkened somewhat by a wave of job cuts announcements in pulp and paper, auto and pharmaceutical manufacturing. Delayed impact from the steep appreciation of the Canadian dollar in 2003-04 (from about 65 U.S. cents to the current level of about 85 U.S. cents) is the most commonly cited factor behind the difficulties in the manufacturing sector, with competition from developing countries an additional challenge for the pulp and paper industry.

5. Following are selected recent economic indicators for the third quarter of 2005:

| Indicator | Change | Period |
|---|--------|----------------|
| ----- | ----- | ----- |
| GDP GROWTH (q/q) | 0.9% | 3Q 2005 |
| TOTAL CPI (y/y) | 2.6% | October 2005 |
| CORE CPI (y/y) | 1.5% | October 2005 |
| ENERGY PRICES (y/y) | 13.5% | October 2005 |
| BUSINESS PROFITS (q/q) | 2.9% | 3Q 2005 |
| BUSINESS INVESTMENT IN M and E (y/y) | 3.0% | 3Q 2005 |
| CONSUMER SPENDING (q/q) | 1.6% | 3Q 2005 |
| UNEMPLOYMENT(m/m) | 6.6% | October 2005 |
| NEW VEHICLE SALES (m/m) | - 7.9% | September 2005 |
| MERCH EXPORTS (m/m) | 2.8% | September 2005 |
| MERCH IMPORTS (m/m) | 1.4% | September 2005 |

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